Internal Revenue Service

memorandum

CC:TL-N-6420-87
Br1:VLDraper

date: APR 29 1987

to: District Counsel, Washington, D.C. CC:WAS

from: Director, Tax Litigation Division CC:TL

subject: [redacted]

ISSUE

Should a motion for an award of litigation costs be settled out of court where the plaintiff prevailed, exhausted his administrative remedies, and the position of the government was unreasonable at the administrative level. 7430.00-00.

CONCLUSION

This is in response to your memorandum dated April 14, 1987, requesting technical advice. We agree that extreme litigation hazards are involved in contesting plaintiff's request for the award of litigating costs and we therefore recommend that you attempt to negotiate a settlement with plaintiff based only on litigation costs.

Plaintiff is requesting fees of $[redacted]. We note, however, that the fees requested for his attorney are $[redacted] and those for his accountant are $[redacted]. As it appears that most of the fees of the accountant were incurred prior to the initiation of the suit in [redacted], we believe that such fees incurred prior to the initiation of the suit should be disallowed.

FACTS

The issue contested by the taxpayer concerned the statute of limitations which affects the time a taxpayer can file a claim for refund or credit attributable to any taxes paid or accured to a foreign country. Under ordinary circumstances, I.R.C. § 6511(a) allows only a period of three years between the time a return is filed and the time a request for refund must be submitted. Section 6511(d)(3)(A), however, provides for a ten year statute of limitations if the refund relates to an overpayment attributable to any taxes paid or accured to a foreign government.

Prior to 1982, the Service's position with respect to section 6511(d)(3)(A) was that only if the initial election of the foreign tax credit was made within the three year statute of limitations of section 6511(a) would the ten year period of section 6511(d)(3)(A) apply to an adjustment in the requested amount. This position of the Service was published in Treas. Reg. § 1.901-1(d), a regulation based on the clear language of a committee report associated with Pub. L. No. 86-780, September 14, 1960, which law re-enacted section 901(a).

The Service changed its position after it lost several cases in which the courts chose to ignore the committee report language in favor of the clear language of the statute. Hart v. United States, 585 F.2d 1025 (Cl. Ct. 1978); United States v. Woodmansee, 578 F.2d 1302 (9th Cir. 1978); Blackmon & Associates, Inc. v. United States, 409 F. Supp. 1264 (N.D. Tex. 1978), aff'd per curiam (5th Cir. May 27, 1980). In 1982, the Service issued an action on decision stating that it would follow the court decisions. A.O.D. 1091, Blackmon & Associates, Inc. v. United States (March 28, 1982). In this the Service stated that it would no longer defend the position of Treas. Reg. § 1.901-1(d) and that it expected that the regulation would be revised to conform to the current position.

The plaintiff requested his refund based on this A.O.D. The Service denied the request, and in spite of repeated efforts by plaintiff's acountant at the administrative level to remedy this erroneous decision, the Service would not alter its decision. Plaintiff's extensive efforts at the administrative level were an attempt to avoid the costs of litigation.

Plaintiff filed a suit for refund in the Claims Court when the statute of limitations had nearly run for the filing of the suit. After several months delay caused by problems in locating plaintiff's returns, the Government conceded the case and a

stipulation was filed. During the litigation period, there had never been any question that the taxpayer's position was the correct one. Rather the delay was caused by attempting to verify that plaintiff's returns were in order with respect to claiming the refund and to a net operating loss carryover matter.

Following the government's concession, plaintiff filed a motion under section 7430 for litigation costs.

DISCUSSION

Section 7430 allows for the award of reasonable litigation costs incurred in a civil proceeding brought by the United States if the taxpayer is the prevailing party and has exhausted his administrative remedies. Section 7430(a) and (b). A taxpayer is a prevailing party if he establishes that the position of the government in the civil proceeding was unreasonable and he has substantially prevailed with respect to the amount in controversy. Section 7430(c)(2)*

We are satisfied from the facts presented that the taxpayer has exhausted his administrative remedies. We also believe that the taxpayer is the prevailing party. As the government conceded the case, the taxpayer has by stipulation prevailed with respect to the whole amount in controversy. Further, we believe that the Claims Court would find the position of the government unreasonable.

The government from the start of the litigation accepted plaintiff's position as correct. Settlement was delayed, however, as a result of delays in obtaining the taxpayer's tax returns from the service center to verify certain details before conceding the case.

It is the position of the Service that the unreasonableness of the government's position under section 7430 must be measured at the litigation level, not the administrative level. Baker v. Commissioner, 787 F.2d 637 (D.C. Cir. 1986), aff'g on this issue, 83 T.C. 822 (1984). There is authority, however, that the measure of reasonableness extends to the administrative level. See, e.g., Powell v. Commissioner, 791 F.2d 385, 5th Cir. 1986, rev'g T.C.M. 1985-27. The Claims Court has recently followed those courts holding that the "position" of the government includes the prelitigation period. Tax Analysts v. United States, No. 440-85T, slip op. (Cl. Ct. April 1, 1987).

*Section 7430 was amended by the Tax Reform Act of 1986. However, those amendments are not relevent to the instant case.

As the Service's position at the administrative level was contrary to both its published position and case authority, such position was "unreasonable." See Phillips v. Commissioner, 88 T.C. No. 26 (March 5, 1987) and Minahan v. Commissioner, 88 T.C. No. 23 (March 5, 1987). As such, the Claims Court would in all likelihood find the "position" of the government unreasonable for the purposes of section 7430. Tax Analysts, supra.

Even at the litigation level, however, the Claims Court would probably find the position of the government unreasonable. Although the government agreed with plaintiff's position after the filing of the petition, a delay in settlement resulted from problems in locating plaintiff's returns. As misplaced files was the whole reason for the court in Tax Analysts finding the government's position "unreasonable," so would we expect the court to similarly find in the instant case. Thus we recommend that the request for attorney's fees be settled.

Settlement of this issue would avoid further cost to the government and avoid plaintiff incurring additional fees in connection with the litigation for which the government would ultimately be liable. The attorney for the Department of Justice believes that if we offer to settle the section 7430 costs, we could limit the hourly fee of the attorney to $75 compared to the current fee of approximately $91. See Order of the Court associated with Tax Analysts, supra, and Columbus Fruit & Vegetable Cooperative Association, Inc. v. United States, 8 Cl. Ct. 525 (1985). The attorney believes that we also might be able to discount the number of hours claimed (although the attorney would not dispute the number requested as she has verified that some of the time plaintiff's attorney spent with her was not included in the charged time).

The language of section 7430 is clear that costs awarded under the section are limited to reasonable litigation costs. Section 7430(a). Based on this language, we believe that plaintiff must be limited to only those costs incurred by its accountant and attorney in connection with the litigation. In addition to attorney's fees of $[redacted], plaintiff has requested reimbursement of its accountant fees of $[redacted]. The Department of Justice attorney has determined that the accountant participated only two hours in the case following the filing of the suit. We believe that accountant fees only for these two hours should be reimbursed plaintiff.

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